

To G20 Finance Ministers and Central Bank Governors

As the global economy continues to recover from the outbreak of COVID-19 and the attendant containment measures put in place by many governments (“the COVID Event”), the Financial Stability Board has shifted its focus from crisis management to reflecting on the important lessons we have learned and sharpening our focus on the road ahead.

The work we are submitting to the G20 focuses on these lessons for financial stability. It also charts a way forward on enhancing resilience in the non-bank financial intermediation (NBFIs) sector and addressing challenges in cross-border payments. This body of work presents promising tools to address vulnerabilities, identifies concrete steps that can be taken to improve the resilience of NBFIs, and reflects consensus around areas for continued vigilance. Importantly, the work reflects the strength that years of coordination have built to develop solutions that can be rapidly applied in times of stress.

Developing a more resilient NBFIs sector

Understanding the implications of the rapidly growing NBFIs sector has been a key priority for the FSB since the 2008 global financial crisis, but work in this area had lagged work in regulating the banking sector in the decade after the FSB’s creation. Accordingly, even before the COVID Event, the FSB had assigned a senior group from both central banks and market regulators to coordinate and drive NBFIs work forward with more focus (the Steering Committee group on NBFIs). We were fortunate to have had this group in place when the COVID Event underlined the importance of analyzing and addressing NBFIs vulnerabilities. The market strains in March 2020 revealed vulnerabilities in parts of the NBFIs sector that need to be addressed with urgency, and these strains were eased only after massive official sector interventions.

Last year, the FSB agreed on an ambitious multi-year workplan to enhance NBFIs resilience, leveraging the strengths of the FSB and standard-setting bodies (SSBs). This workplan builds on the holistic review of the March 2020 market turmoil that we submitted to the G20 in November 2020. One set of initiatives under the workplan focuses on specific risk factors that appear to have propagated stress, including liquidity strains, during the COVID Event.

Assessing and addressing MMF vulnerabilities

For example, vulnerabilities in money market funds (MMFs) contributed to stress in a number of jurisdictions at that time. Following work in collaboration with International Organization of Securities Commissions (IOSCO), the FSB is delivering a final report on policy proposals to enhance MMF resilience. As specified in the report, FSB members are assessing, or will assess, MMF vulnerabilities in their jurisdiction and will address them using the framework and

policy toolkit in the report, in line with their domestic legal frameworks. The FSB, working with IOSCO, will then by end-2023 take stock of progress made by jurisdictions, and by 2026 assess the effectiveness of the measures taken. This creates a path forward for jurisdictions to make meaningful progress in addressing structural vulnerabilities in MMFs, including their susceptibility to sudden and disruptive redemptions, and the challenges they face in selling assets, particularly under stressed conditions. Further, the FSB and IOSCO intend to carry out follow-up work, complementing MMF policy reforms, to enhance the functioning and resilience of short-term funding markets.

Future focus: Understanding interconnectedness and enhancing resilience across NBFIs

The FSB has also made considerable progress on assessing vulnerabilities and identifying policy topics for further consideration in other areas within NBFIs.

Open-ended funds

The FSB and IOSCO are jointly undertaking analytical work on assessing liquidity risk and its management in open-ended funds. As open-ended funds play an increasingly large role in channeling financing to the real economy, consideration should be given to enhancing their resilience to mitigate structural vulnerabilities and broader market repercussions. This analysis will set the stage for the FSB to assess and report on the effectiveness of its recommendations in 2017 on liquidity mismatch in open-ended funds from a financial stability perspective.

Impact of margin calls

Further, while central counterparties (CCPs) demonstrated resilience during the COVID Event, in some instances margin calls may have been larger than market participants expected. The NBFIs work program has identified the need for better understanding of the impact that margin calls could have, including from steps that market participants took to meet these calls. In response, the Committee on Payments and Market Infrastructures (CPMI), IOSCO, and the Basel Committee on Banking Supervision (BCBS) will shortly complete an examination of margin calls in centrally cleared and non-centrally cleared derivatives markets, and the preparedness of market participants to meet margin calls through their liquidity management. This will provide SSBs a firm foundation from which to further explore the questions raised through this analysis.

Core funding markets

Work also continues on the structure of core funding markets and the demand for and supply of liquidity during periods of stress. The FSB, in collaboration with IOSCO, has begun a targeted exercise on corporate and government bond market liquidity developments and their drivers – including the role of G20 reforms – particularly as they relate to the March 2020 turmoil. This work is already underway and will continue into 2022.

Towards a systemic risk perspective on NBFIs

While we have made considerable progress in a short amount of time, much remains to be done. In addition to the ongoing work on the specific issues outlined above, the FSB will also leverage insights from this analysis to develop a systemic risk perspective on NBFIs and policies to address such risks.

Further understanding of systemic risks in NBFIs will involve analysis of interconnections and how risks propagate. For example, the functioning and resilience of the NBFIs ecosystem is dependent on the availability of liquidity and its effective intermediation under stressed market conditions.

Authorities may need to consider how they can better leverage well-established policy measures for NBFIs to ensure their adequacy from a systemic risk perspective. Further, additional data and tools to enhance the ability to monitor, assess and mitigate systemic risk will need to be investigated. Authorities should retain flexibility when implementing such tools to ensure that financial stability risks from new activities and entities are addressed. International cooperation and coordination on these issues will be key to mitigate potential spillovers from cross-border linkages in NBFIs; ensure a level playing field across firms and jurisdictions; and reduce any harmful market fragmentation.

The FSB will submit to G20 Leaders a full progress report on our work to enhance resilience of NBFIs. In addition to providing a more complete picture of the work being carried forward, this NBFIs progress report will highlight areas where continued focus is needed.

Payments services that are fit for the future

The COVID Event has brought into even sharper focus the need to address the limitations of our current arrangements for cross-border payments. Last year, we delivered a roadmap to enhance cross-border payments, so they are faster, more inclusive, less expensive and more transparent. We are submitting our progress report on the roadmap, which also confirms the next steps for 2022 and beyond. Action from the private and public sectors, working together, will be critical to the success of the roadmap, including through investment in upgraded and new systems, processes and technologies.

A foundational step in this roadmap is to set specific global targets for addressing the challenges of cost, speed, transparency and access experienced by end-users by end-2027. These targets, which have undergone public consultation and are being submitted to the G20, will play an important role in defining the ambition of our work and creating accountability for its progress. The targets will enable us to determine whether the existing roadmap actions are sufficient or if additional actions may be needed.

Work on fostering the soundness of global stablecoins is an important part of the roadmap for enhancing cross-border payments. We are submitting our report on the progress made on the implementation of the FSB's High-Level Recommendations for Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements. The report lays the groundwork for a review of these recommendations, which the FSB will begin, in consultation with other relevant SSBs and international organizations, in 2022. The review will identify any potential overlaps or gaps,

set out how any such gaps could be addressed and propose an update to the FSB high-level recommendations, if appropriate.

Turning to the topic of technology and innovation more broadly, we are also presenting the FSB's latest work on cyber incident reporting. This report brings together cross-sectoral expertise to explore whether harmonization in cyber incident reporting can be achieved, and areas where future work may be needed.

Conclusion

The reports outlined above are initial steps in what will be multi-year programs on NBF1 and cross-border payments focused on ensuring that the global financial system remains resilient in the face of rapid innovation and technological changes. Advancing this work will require strong commitment and coordination across the G20, FSB, and SSBs.

The FSB has demonstrated its unflinching resolve to maintain global financial stability by working through its members and forging partnerships with key stakeholders. That collaboration will be key to our ability to support a resilient financial system and drive forward a strong, sustainable global recovery.

Yours sincerely,



Randal K. Quarles